## Background

General Casualty Company of Wisconsin (General Casualty) is the lead company in the General Casualty Group. General Casualty has the following subsidiaries, Regent Insurance Company, General Casualty Insurance Company, Hoosier Insurance Company, Blue Ridge Insurance Company, Blue Ridge Indemnity Company, Southern Guaranty Insurance Company, Southern Pilot Insurance Company, Southern Fire & Casualty Company and National Farmers Union Property and Casualty Company (NFU) and its wholly owned subsidiary United Security Insurance Company (USIC). General Casualty purchased NFU on October 31, 2008 from an affiliate, QBE Reinsurance Corporation

Unigard Insurance Company (Unigard) is the lead company in the Unigard Group. Unigard has one subsidiary, Unigard Indemnity Company.

The Management Discussion and Analysis for General Casualty and Unigard, collectively referred to as QBE Regional Insurance Companies (Company), excluding NFU and USIC, is prepared on a combined basis because they utilize an intercompany pooling agreement (see Exhibit 1).

All of the outstanding capital stock of the Company is owned by QBE Regional Companies (N.A.), Inc., which is ultimately a wholly-owned subsidiary of QBE Insurance Group Limited (QBE), a company incorporated under the laws of Australia.

## Company Overview

The Company operates in selected states throughout the United States and offers a comprehensive portfolio of personal and commercial lines products for individuals and small to medium size businesses and organizations. The products are distributed exclusively through a network of approximately 1,700 independent agencies.

Insurance operations are conducted in 33 states. General Casualty operates in 25 states in eastern and central United States and Unigard operates in 8 western states. The Company writes commercial lines in all 33 states and personal lines in 23 states. A strong local presence is maintained throughout the operating territory through a network of field offices. The Company feels it is well positioned to attract and retain profitable business in the markets targeted by independent agencies because of its strong agency relationships, product and service capabilities, and a business model that adheres to the regional company approach preferred by these agencies.

## Results of Operations

In 2008, the Company recorded $1,198.8 million in gross premiums written, of which 64% percent was commercial lines and 36% was personal lines, a combined ratio of 86.5% and net income of $159.6 million.

Gross premiums written for the year ended December 31, 2008 decreased 12.2% compared to 2007 reflecting a reduction in both commercial lines and personal lines production. The decrease in premiums during 2008 was due to the continued impact of soft market conditions and reductions in premiums associated with profit improvement strategies. The Company continues to maintain its underwriting and pricing discipline.

Commercial lines gross premiums written decreased 12.5% compared to prior year as new and renewal business were impacted by aggressive pricing by competitors. Overall rate levels decreased 2.1% relative to expiring premium and retention ratios decreased 0.7 points compared to prior year.

Personal lines gross premiums written decreased 11.8% compared to prior year reflecting a shortfall in new business production partially offset by increased rates. Overall rate levels increased 3.8% and retention ratios decreased 7.3 points compared to prior year. The Company continues to maintain pricing discipline in a market that is continuing to experience rate declines.

The current accident year loss ratio for all lines increased 1.9 points to 67.6% from 65.7% for the accident years 2008 and 2007, respectively. This increase is primarily attributable to higher catastrophe losses net of reinsurance recoveries.

In 2008, the Company recorded $160.3m of favorable development on prior accident year loss reserves in its operating results. Reserves for incurred losses and loss adjustment expenses attributable to events of prior years have decreased in 2008 as a result of changes in the estimates of ultimate incurred loss and loss adjustment expense. Development on known claims was better then expected in 2008, particularly in long tailed lines such as Auto Liability, Commercial Multiple Peril and Workers Compensation.

The underwriting expense ratio increased 2.3 points to 34.2% in 2008 compared to 31.9% in 2007, primarily due to the decrease in gross premiums written. Underwriting expenses excluding certain variable costs such as commissions and premium taxes are typically fixed over the short-term and do not vary directly with the premium volumes.

Investment earnings, net of investment expenses and including net realized losses were $39.2 million for the year ended December 31, 2008 compared to $111.2 million for the same time period of 2007. The components of investment earnings for 2008 and 2007 are as follows:

| | 2008 | 2007 |
|---|---|---|
| Net investment income | $ 92.8 | $ 126.4 |
| Net realized capital losses | (53.6) | (15.2) |
| Net investment earnings | $ 39.2 | $ 111.2 |

The decrease in current investment income is driven by the following factors:

- The downturn in the major stock markets during 2008
- Maturing higher yield fixed maturity securities being reinvested at lower current rates
- Purchase of NFU
- Dividends paid to parent.

**Liquidity, Asset/Liability Matching and Capital Resources**

On December 31, 2008 the Company had total assets of $2,429.4 million, liabilities of $1,678.7 million and policyholders' surplus of $750.7 million.

Invested Assets

Since June 1, 2007, the invested assets of the Company are managed, under an investment management agreement, by Minster Court Asset Management Pty Limited (MCAM), a fully owned subsidiary of QBE. Prior to June 1, 2007, the invested assets were managed by Winterthur Investment Management Corporation (WIMCO), a wholly owned subsidiary of the Company, under an investment services agreement.

MCAM aims to provide state-of-the-art fund management products that produce consistent returns in a risk-controlled environment. MCAM's investment approach is absolute return driven, focusing the investments on quality assets that generate visible, stable earning streams. The company has a disciplined methodology for managing investments and tolerance for investment related risk. MCAM measures and assesses the actual risk of investment portfolios regularly against agreed benchmarks and investment income targets, to mitigate against investing in unrewarding risk.

Effective fixed interest management comes from successfully forecasting changes in interest rates, changes in the shape of the yield curve, in sector margins and credit risks and from constructing diversified portfolios that reflect these forecasts. In addition to the company's investment guidelines which require a well diversified portfolio limiting counterparty risk exposure, MCAM manages fixed income credit risk by having a minimum credit grade requirement (A3 by Moody's), a 25% of portfolio NAV limit to investment below Aa3, a 10% of the total non-government issue size of a security limit on individual bonds, and a minimum 10% of the portfolio required to be invested in AAA rated non-corporate securities.

As of December 31, 2008, 56% of the portfolio was invested in AAA rated securities, 28% in AA rated and 16% of the portfolio was invested in A. In addition, 70% of the portfolio was held in securities maturing in 12 months or less.

The Company had no investments in sub-prime mortgage assets, collateralized debt, collateralized loans or similar structured products.

On a quarterly basis, the Company examines the overall portfolio for evidence of impairment. The assessment of whether impairment to the fixed-maturity and equity portfolio has occurred is based on an evaluation, on an individual security basis, of the underlying reasons for the decline in fair value; the extent to which such changes are attributable to interest rates; market-related factors other than interest rates; as well as the financial condition, business prospects, and other fundamental factors specific to the issuer. The Company recognized impairment losses of $12.1 million related to equity investments in 2008.

Liquidity

Typically, the Company's short-term capital needs will be generated from operations. In 2008, the Company recorded negative net cash from operations of $315.1 million. This was primarily due to $243.5 million of cash used in the quota share and loss portfolio transfer agreements entered into during 2008 (see Reinsurance) and also due to adverse weather events in 2008 that were unfavorable to plan and prior year. The investment portfolio produced positive cash flow of $102.2 million and the amount that will be produced in future years is reasonably predictable since a majority of the portfolio is invested in debt securities.

The cash flow produced from the insurance operations can be more volatile. The Company writes contracts that include catastrophic events, such as earthquakes, brushfires, and windstorms. The Company utilizes various means, including catastrophe reinsurance, to limit its exposures to such events. However, an unusually large number of catastrophes during the year or a spike in the frequency or severity of non-catastrophe losses could negatively impact the amount of positive cash flow produced from the insurance operations. However, it would be an unusual situation if the Company needed to prematurely liquidate invested assets in order to meet short-term capital needs.

Cash liquidity to meet the Company's daily operating requirements is also an integral part and priority of the investment strategy and philosophy. Based upon cash flow modeling and experience, cash needs are anticipated and held in operational accounts and cash equivalent investments. These accounts and investments provide the Company the funds necessary to conduct its daily business. In addition, MCAM's internal guidelines require a minimum of 5% of portfolio assets to mature in less than 6 months insuring that liquid assets are readily available.

Reinsurance

The Company participates in reinsurance programs as a means to reduce its net liability to loss and loss expense. This is accomplished through facultative reinsurance on individual risks, treaty programs specific to special coverages or layers of protection, and treaty programs that apply to all companies within the group.

The primary purpose of the Company's treaty reinsurance program is to protect the Company's surplus as regards policyholders and ensure the financial viability of the organization. This is done by selecting the appropriate retentions and limits to reduce the impact of individual claims, and to protect against the catastrophic loss.

A secondary purpose is to provide additional capacity by providing protection for very large risks or for unique exposures. This allows the insurance operations to meet the needs of their customers while also protecting the company from unwanted volatility.

The Company purchases reinsurance protection for three primary exposure areas: property catastrophe losses, property per risk excess losses, and casualty per risk excess losses. For these programs, there are both consolidated treaties and individual treaties with lower retention levels for individual companies.

The Company along with it's United States based affiliates have the ability to purchase reinsurance on a national scale with the attendant cost benefits, while still operating via regional statutory companies. This unique arrangement is attractive to reinsurers as there is little loss correlation among companies, enhancing the diversification of reinsurer portfolios. The structure is beneficial to the statutory companies because they have national buying power in spite of their size and they can still purchase reinsurance to protect for their own niche coverages.

The consolidated programs for the year ended December 31, 2008 were structured as follows:

| Program | Retention | Coverage | Limit |
|---|---|---|---|
| Property catastrophe excess | $25 million | $575 million | $600 million |
| Property catastrophe aggregate | $25 million | $25 million | $50 million |
| Terrorism annual aggregate | $10 million | $40 million | $50 million |
| Property per risk excess of loss | $2.5 million | $47.5 million | $50 million |
| Casualty clash excess of loss | $2.5 million | $7.5 million | $10 million |
| Workers compensation excess of loss | $2.5 million | $7.5 million | $10 million |
| Workers compensation catastrophe excess | $10 million | $40 million | $50 million |
| Workers compensation contingency cat excess | $90 million | $2.5 million | $92.5 million |

The property catastrophe excess cover protects against individual catastrophic events that exceed $25 million. The property catastrophe aggregate cover protects against accumulated catastrophic events that exceed $25 million. The Company participates in a Reinstatement Premium Protection Treaty on catastrophe treaties. Additionally, the Company participates in a Global Property Catastrophe aggregate treaty that covers QBE's worldwide operations against accumulated catastrophic events.

The combined operations of the Company and its U.S. based affiliates use a combination of direct, broker and internal reinsurers to meet their reinsurance needs. Each of these entities provides pricing, structure, and underwriting expertise. The other advantage of this approach is that the presence of competing reinsurers on the program helps ensure that quoted pricing and terms are reflective of current market conditions.

During 2008, the General Casualty Group and Unigard Group entered into quota share agreements with an affiliated company, Equator Reinsurances Limited (Equator Re). Equator Re is QBE's wholly owned captive reinsurer that provides excess of loss and proportional reinsurance protection below Group retentions to various operating subsidiaries. The General Casualty Group's quota share agreement, effective January 1, 2008, covers 25% of all in-force, new and renewed business related to commercial policies, excluding commercial umbrella and commercial auto. In addition, the General Casualty Group entered into a loss portfolio agreement to transfer 25% of the outstanding loss reserves as of December 31, 2007 for these same commercial policies. The Unigard Group's quota share agreement, effective January 1, 2008, covers 25% of all new and renewed business. All lines of business are included.

Shareholder Dividends

The Company is part of QBE the Americas which is a division of QBE. The Company provides funding to QBE the Americas through shareholder dividend payments. The Company's intention is to target payments that will provide sufficient funds and also allow the Company to maintain a capital position which supports a financial strength rating from AM Best that will allow it to effectively compete in the marketplace.

The Company obtained the required regulatory approvals to pay extraordinary shareholder dividends of $275.0 million in March 2008. These payments were used to facilitate acquisitions, partially fund debt service requirements as well as provide a normal dividend to QBE.

## Loss Reserves

Liabilities for loss and loss adjustment expense represent the estimated ultimate net cost of all reported and unreported losses incurred, net of salvage and subrogation. These liabilities are based on individual case estimates for reported losses on known events and estimates of incurred but not reported losses. Losses and loss expense liabilities are necessarily based on estimates, and the ultimate liabilities may vary from such estimates. These estimates are continually reviewed and adjusted as necessary as experience develops or as new information becomes known; such adjustments are included in current operations.

Exposure to asbestos and environmental (A&E) claims has existed for many years. While analyzed separately, A&E claims are managed together. A litigation unit within the Claim Department monitors individual case estimates as claims emerge and are adjusted. Bulk and IBNR reserve estimates are determined based on an independent review by an external actuarial firm. This special analysis is performed every three years with annual monitoring and updates as part of the loss review work associated with the statement of actuarial opinion preparation. An independent review was completed in the second quarter of 2007.

## Off-Balance Sheet Arrangement

The Company does not have transactions, arrangements or other relationships with entities or other persons that that are reasonably likely to affect materially liquidity or the availability of or requirements for capital resources.

## Participation in Yield Financings, Highly Leveraged Transactions or Non-Investment Grade Loans and Investments

The Company does not have participation or involvement in Yield Financings, Highly Leveraged Transactions or Non-Investment Grade Loans and Investments that has had or is reasonably likely to have a material effect on its financial condition or results of operations.

## Subsequent Events

Effective January 1, 2009, the ownership of USIC was transferred by NFU to General Casualty through a shareholder dividend. The dividend was declared and approved by NFU's Board of Directors in November 2008. Also effective January 1, 2009, NFU and USIC were added to the Company's intercompany pooling agreement.

## Exhibit I – Pooling Arrangement Summary

| Participating Companies | Pool % |
|---|---|
| General Casualty Company of Wisconsin | 39.0 |
| Regent Insurance Company | 9.0 |
| Blue Ridge Insurance Company | 6.0 |
| General Casualty Insurance Company | 7.0 |
| Hoosier Insurance Company | 4.0 |
| Blue Ridge Indemnity Company | 2.0 |
| Southern Guaranty Insurance Company | 10.0 |
| Southern Fire & Casualty Company | 0.0 |
| Southern Pilot Insurance Company | 0.0 |
| Unigard Insurance Company | 20.0 |
| Unigard Indemnity Company | 3.0 |